Overview of the Macedonian Electricity Sector Privatization Process

MEINL BANK CONSORTIUM

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CESI

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Table of Contents

1. Privatization Plan
2. Macroeconomic Environment
3. Macedonian Electricity Sector Structure
4. Electricity Supply and Demand
5. Electricity Generation and Mines of ESM
6. Electricity Transmission and Market Balancing by MEPSO
7. Electricity Distribution and Supply of ESM
8. Tariff Regulation
9. Financial Overview of old ESM including MEPSO
10. Privatization Tender Process
11. Contact Details

1. Privatization Plan

The Macedonian Government is proposing to privatize the Macedonian electricity industry in the following manner: [1]

- **The privatization object is AD Elektrostopanstvo na Makedonija (ESM), which is a vertically integrated electricity company composed of the distribution network, thermal and hydro power plants, and the lignite mines (the privatization object does not include the transmission network, spun off as MESPO)**
- **A majority stake of ESM (not less than 51%) will be offered for sale to a Strategic Investor or a Consortium of Strategic and Financial Investors (led by a Strategic Investor)**
- **A minority stake between 0% and 10% will be offered to employees and an X% stake[2] may (if desired) be purchased by the European Bank for Reconstruction and Development (EBRD)**
- **The Strategic Investor must be a qualified investor meeting three major qualification criteria:**
  - Operational experience in the relevant industry sectors
  - Market experience in a liberalized electricity market
  - Financial strength
- **The privatization tender will be a competitive, transparent international privatization tender**
- **The transaction should be completed during calendar year 2005**

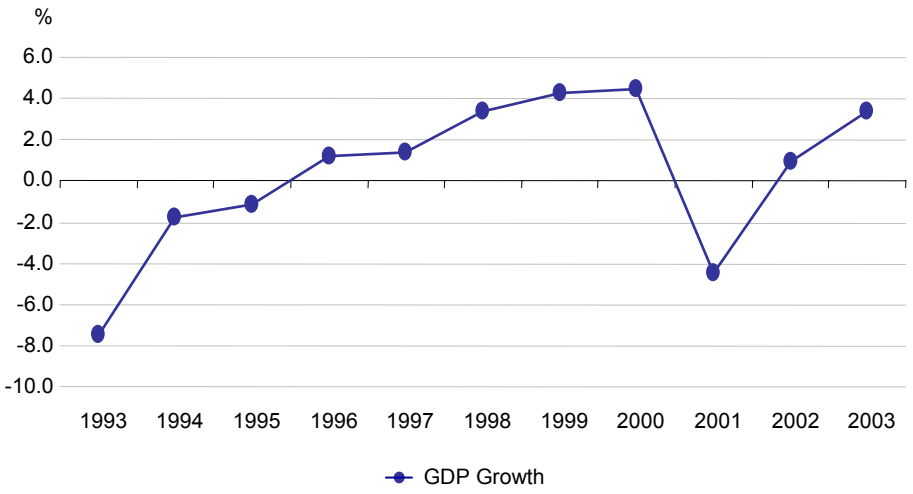
[1] Macedonian Government Decree for Commencing of the ESM Privatization Procedure, 26 January 2005

[2] Determined by "Conditional deferred share sale and purchase agreement between the Macedonian Government and EBRD"

2. Macroeconomic Environment

Geographic Location

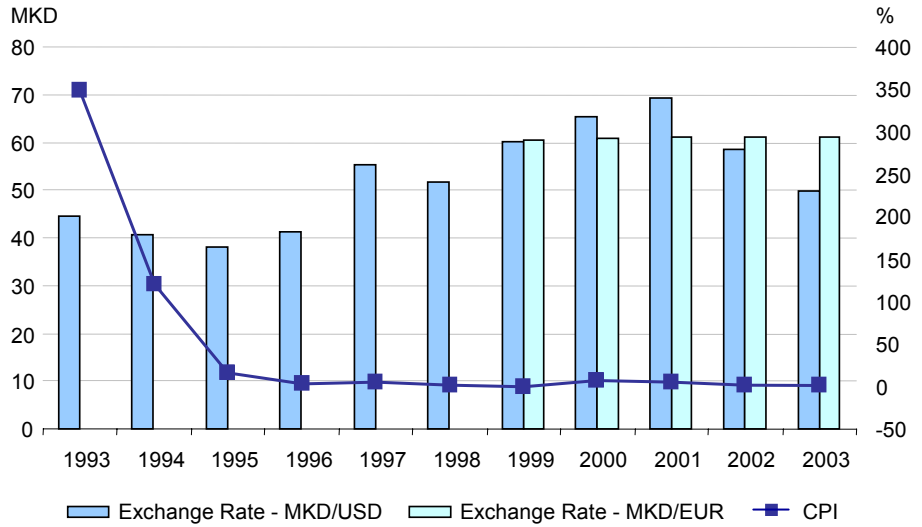
GDP Growth Rate



General Data

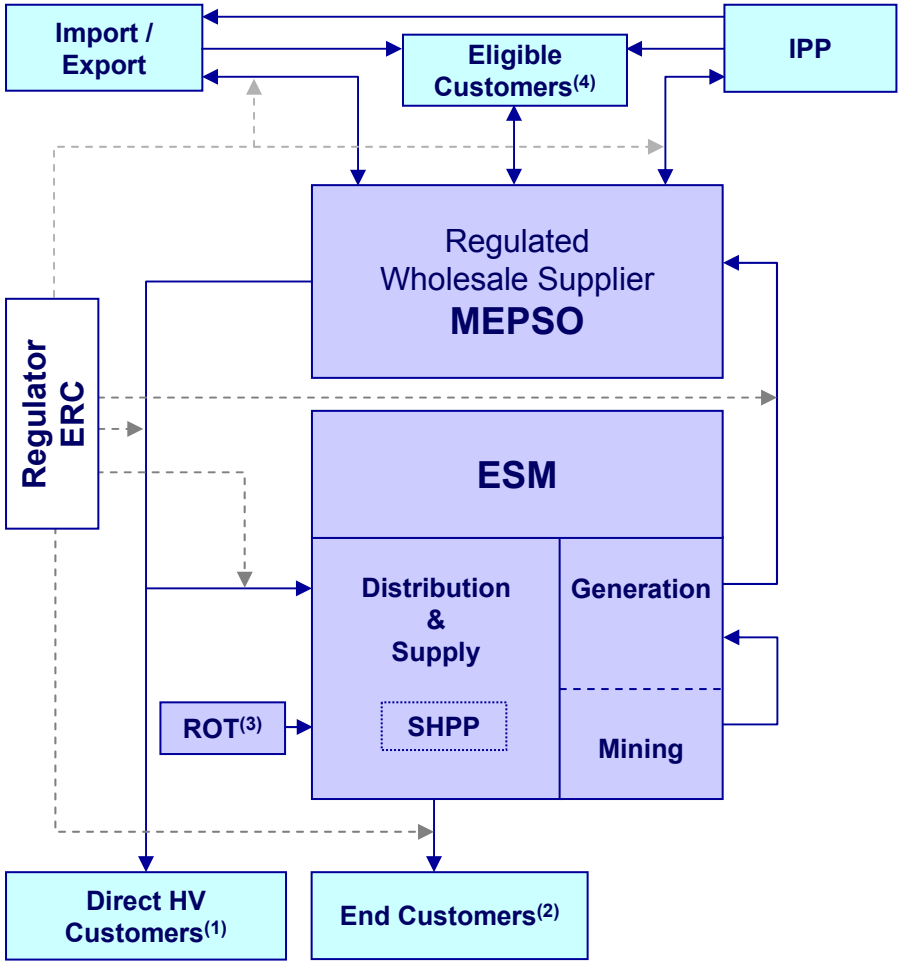
- Area: 25,713 km^2
- Population: 2,022,547 (in 2002)
- GDP volume: US$ 4.7 bil. (in 2003)
- GDP per capita: US$ 2,324 (in 2003)
- Foreign direct investment: US$ 128.3 mil. (in 2004)
- Foreign debt credit rating: “BB/Positive/B” by S&P
- Corporate income tax: 15%
- Value added tax: 18%
- Key foreign investors: Matav, National Bank of Greece, Hellenic Petroleum, QBE

Exchange Rate and Inflation



3. Macedonian Electricity Sector Structure

The New Market Model



(1) Large Industrial Customers directly connected to the HV grid

(2) Distribution Customers connected to the distribution network

(3) Seven out of ten small hydro power plants (SHPP) are under concession

(4) All of the non-residential customers get eligible as of January 1st 2008

Structure of the Electricity Sector

- **Industry Restructuring**
  The Macedonian electricity industry is proposed to be restructured in full EU compliance. The mining and generation, and the distribution and supply businesses will be legally separated within a holding structure.

- **Regulated Wholesale Supplier and Market Maker**
  The Regulated Wholesale Supplier, MEPSO, will be a regulated public supplier under the new market structure. MEPSO will have regulated power purchase and delivery contracts with the generation and the distribution subsidiaries of ESM holding. It will also supply the direct HV grid customers until they become eligible and manage the system and market operation as well as the system balancing.

- **Generation**
  Under the market structure to be enforced as of January 2006, long term power purchase agreements will be negotiated between ESM and MEPSO for the power plants' generation capacities. The demand and supply imbalance of the domestic tariff market will have to be balanced with imported electricity by MEPSO.

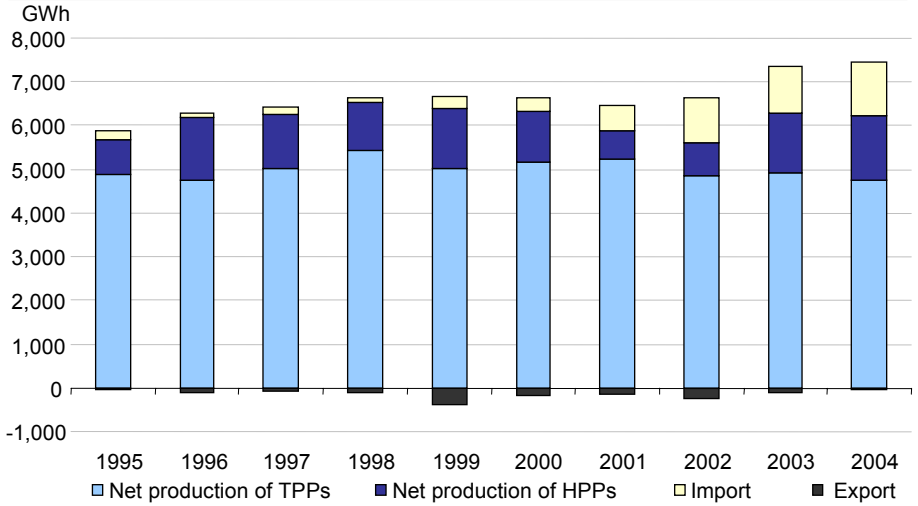
- **Mines**
  Bitola and Oslomey power plants have captive and integrated lignite mines adjacent to the plants' sites. Annual lignite production amounts to 7 million tons of lignite. Some extension of mining operations is envisaged.

- **Distribution & Supply**
  The distribution branch manages single nationwide distribution and supply operation. Under the new market model it will be covering the distribution demand with electricity procured from MEPSO under a regulated power delivery contract. According to the regional market policy, household customers will remain captive until 2015.

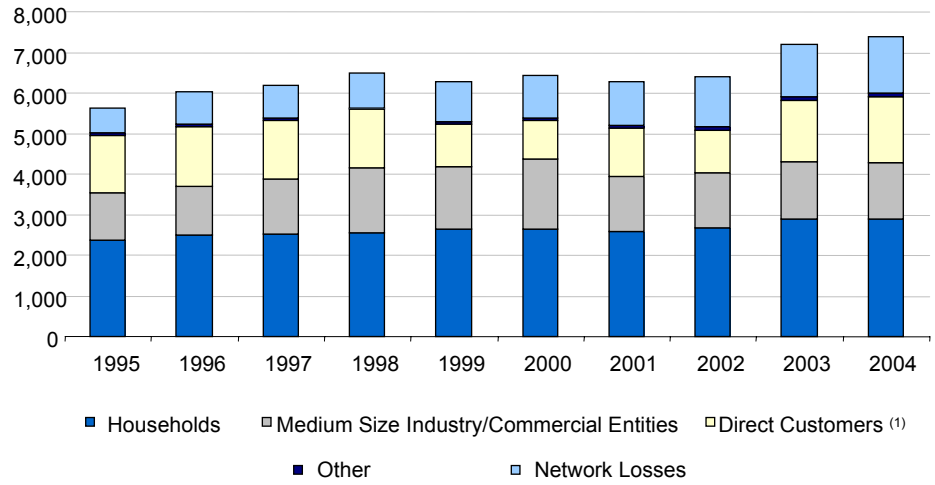
- **Regulator: ERC**
  The regulated market will be liberalized step-by-step. As the competition and liquidity increases, regulation will be limited to natural monopolies only.

4. Electricity Supply and Demand

Electricity Generation, Import and Export



Electricity Consumption



(1) Customers directly connected to HV grid

Electricity Generation and Consumption

➢ Supply

Current generation capacity of the electricity sector is 1,571 MW, and consists of three thermal and five major hydro power plants and several small hydro power plants. Net output in 2003 was 6,272 GWh, with an increase of 12% over 2002. The Bitola power plant accounted for approximately 72% of total production. Thermal power generation is steady and will continue to represent the dominant share of domestic generation.

Hydro power generation follows the annual hydrology and increased in 2004 after commissioning of a new hydro power plant.

As large industrial customers will start becoming eligible consumers in the near future, it is expected that they will be selecting their supplier on the regional electricity market.

Due to the supply / demand imbalance of the domestic market, electricity import is rising following the increase in overall demand.(2)

➢ Demand

In 2003, net consumption reached 5,909 GWh, 14% higher than in 2002. Peak demand has constantly increased during the period 1998-2003, with an annual average growth rate of 3%.

The electricity consumption of households is increasing at a steady pace.

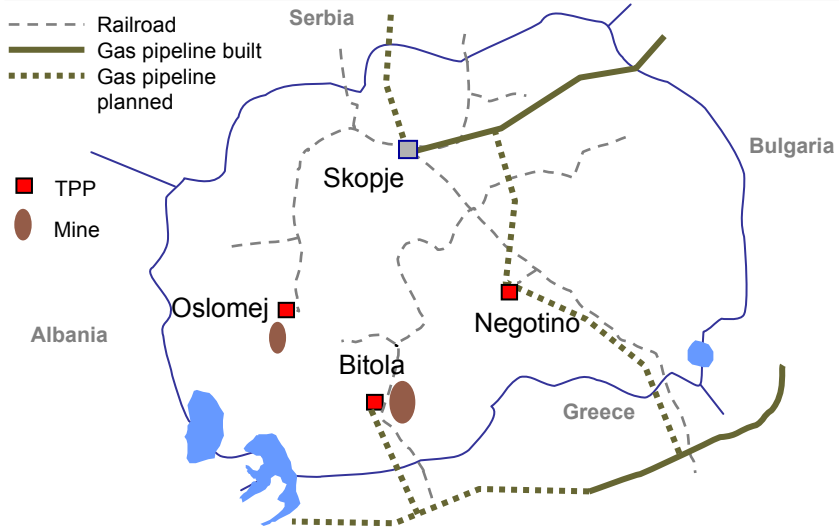
Large industry has significantly increased its demand after the privatization of the heavy metal smelters in the country.

Once the ongoing privatization of the non-ferrous mines and industry is finished, it is expected that the medium size industry demand will increase and return to the level of 1998 – 2000.

(2) ESM recently announced a tender for electricity import of 2.3 TWh for the period of May 2005 to April 2006.

5. Electricity Generation and Mines of ESM

Geographic Location of the Thermal Power Plants



Geographic Location of the Hydro Power Plants

General Information

- **Mines**
  Current lignite mines will supply their respective power plants with lignite for approximately 18 more years. Some new investments are projected for technology and expansion to exploit the remaining coal deposits.

- **Natural gas**
  Southeast European natural gas infrastructure development offers fuel diversification and re-powering possibilities for the thermal power plants in Macedonia.

- **Hydro power**
  A new ESM hydro power plant Sveta Petka is already under construction on the Treska river cascading with HPP Kozjak downstream, where more efficient water management will be achieved. All of the large HPPs have recently been completely refurbished, been automated, and have had their capacity increased.

Generation overview

Power Plant	Number of units	Capacity in MW	Production in GWh/2004
TPP Bitola	3	675	4,362
TPP Oslomej	1	125	373
TPP Negotino	1	210	0
Mavrovo Group HPP Vrutok	4	168	447
Mavrovo Group HPP Vrben	2	13	41
Mavrovo Group HPP Raven	3	24	45
HPP Shpilje	3	84	367
HPP Globochica	2	42	233
HPP Tikvesh	4	112	150
HPP Kozjak	2	80	44
ROT SHPP[1]	16	27	109
Other SHPP	6	11	40

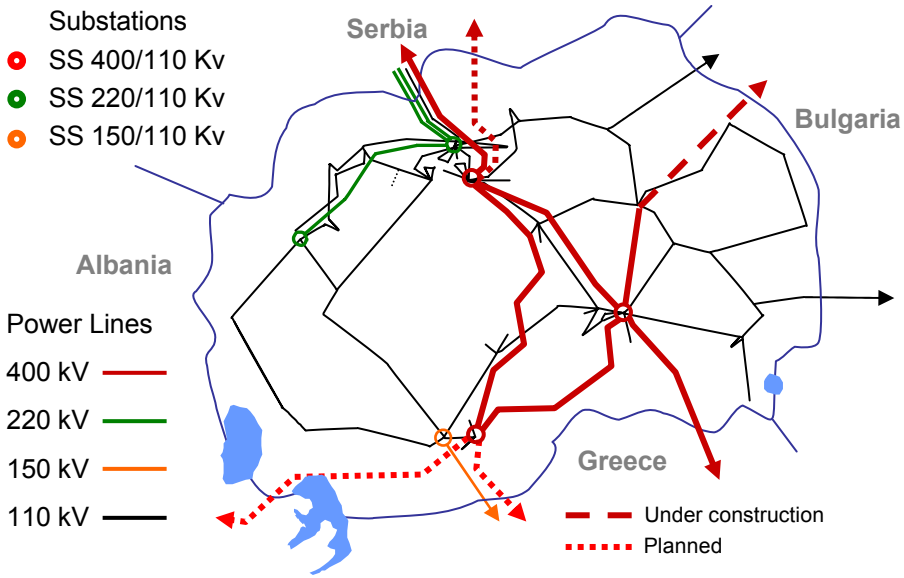
[1] Seven out of ten small hydro power plants are under concession

6. Electricity Transmission and Market Balancing by MEPSO

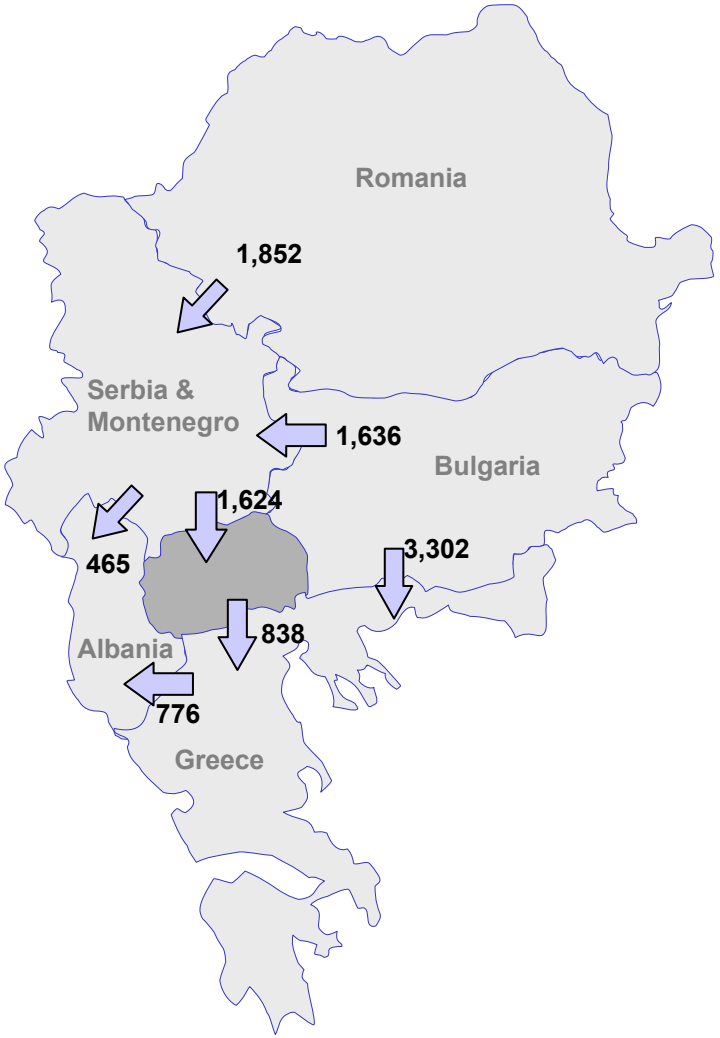
Macedonian Transmission System and Market Operator

- **MEPSO** was established on 31 December 2004 as the national grid company and transmission system operator. MEPSO manages the electricity transmission and third party transits through the Macedonian HV grid. MEPSO is a member of the SEETSO zone and an adherent to the CBT mechanism.
- **Regulated Wholesale Supplier:** As a regulated wholesale supplier MEPSO procures the entire generation of ESM and balances the deficit by imports. MEPSO further supplies the procured electricity to the HV grid customers and to the distribution network.
- **Market Operator:** MEPSO will also administer market contracts and will perform the market clearing and settlement of imbalances between market participants.
- **Interconnections:** Further to its existing north-south interconnections, MEPSO is also developing an east-west electricity corridor.

High Voltage Network

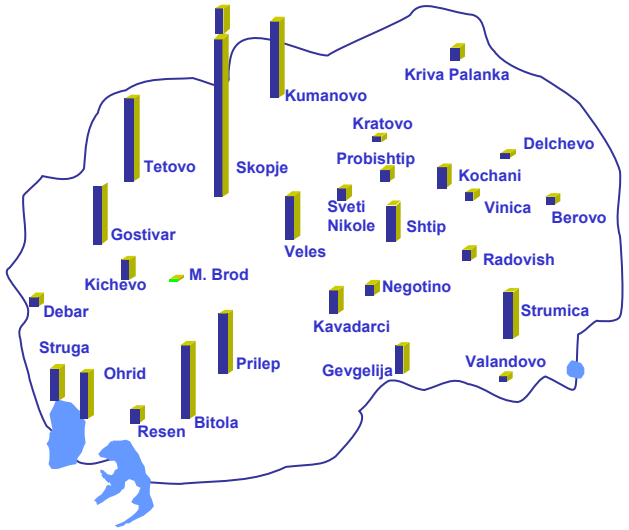


SEE Electricity Exchange in 2003 [GWh]



7. Electricity Distribution and Supply of ESM

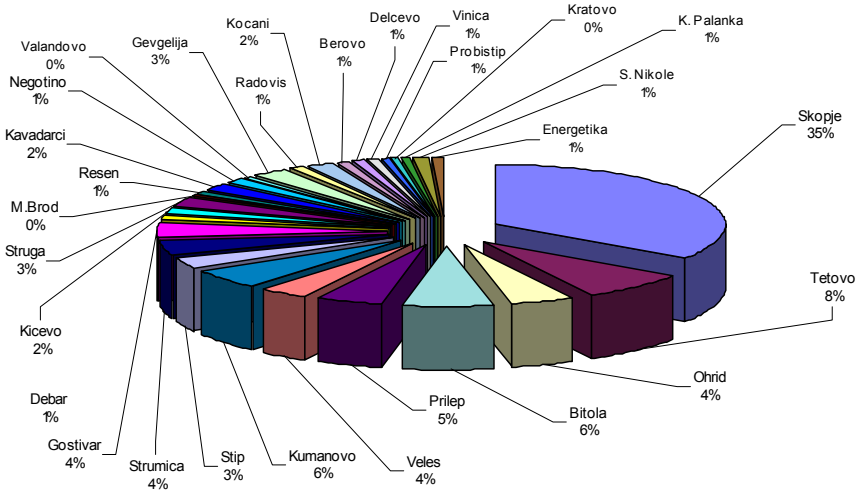
Municipality Electricity Supply



General Information

- ESM Distribution operates the single electricity distribution network in the country, which covers the entire national electricity distribution market. The country is practically 100% electrified.
- The demand of the distribution networks' customers is steadily growing and represents a major share in the domestic consumption.
- There remains room for efficiency improvement at the technical, commercial and organizational level. The collection rate is improving (currently approaching 80%) but still requires concentrated improvements in specific areas.
- Experienced staff is evenly distributed throughout the country.
- There are three meter-calibrating laboratories: Skopje, Bitola and Strumica.

Sales by Distribution Units (2003)



Selected Data

		2004	2003	2002
Sales Volume	GWh	4,373	4,378	4,117
Number of Customers		721,185	719,736	703,836
Average Electricity Price	Mkd/MWh	2,768	2,726	2,772
Collection Rate	%	70-80	70	68
Distribution Losses	GWh	1,199	1,083	1,053
Distribution Losses	%	22	20	20

8. Tariff Regulation[1]

Revenue formula for distribution business

$MAR_t = (MAR_{t-1} * (1+CPI_t)*(1-X)-K_t)*a + (1-a)*P_t – S_t - Z_t$

$MAR_0 = O + L + D + T + RA$

$$(1+CPI_t)\cdot(1-X) \geq \frac{\sum_i \sum_j p_t^{ij} \cdot q_{t-1}^{ij}}{\sum_i \sum_j p_{t-1}^{ij} \cdot q_{t-1}^{ij}}$$

MAR	maximum allowed revenue
CPI	consumer price index
X	efficiency factor
K	correction factor
a	combined method factor
P	planned revenue
S	profit allocation factor
Z	value of actual (total) losses
o	base year = 2004
O	operational expenses
L	technical losses
D	depreciation
T	tax
RA	return on regulated asset base
p^{ij}	tariff for consumer group j in tariff group i
q^{ij}	electricity volume for consumer group j in tariff group i

Tariff methodology

- The energy industry regulator ERC has published the new regulatory methodology[2] on 30 December 2004
- The new tariff regulation applies the following methodologies:
  - maximum allowed revenue methodology
  - maximum allowed price methodology
  - and the combination of the two methodologies
- Short overview of the revenue formula of the electricity distribution business is presented on this page
- The first regulatory period is 1.1.2005 to 31.12.2007
- The tariff methodology regulates all three sub-sectors of the electricity industry:
  - Generation
  - Transmission
  - Distribution

[1] The English translation of the tariff methodology is available from the Meinl Bank Consortium on written request.
[2] "Decree on defining the manner and conditions for electricity price regulation," 30 December 2004

9. Financial Overview of Old ESM including MEPSO (transmission system)

(Privatization object for tender will not include MEPSO)

Profit & Loss of ESM [1]

In MKD tsd	2003	2002	2001
Electricity revenue	14,232,460	13,105,260	13,156,987
Other operating income	1,008,137	1,014,965	1,778,244
Total revenues	**15,240,597**	**14,120,225**	**14,935,231**
Purchased electricity	-2,106,012	-1,961,170	-796,645
Materials and spare parts	-1,741,738	-2,667,342	-2,464,153
Repairs and maintenance	-756,453	-936,815	-1,016,955
Staff costs	-3,602,818	-3,544,812	-3,248,588
Other operating expenses	-1,789,043	-2,498,502	-2,114,005
Total operating expenses	**-9,996,064**	**-11,608,641**	**-9,640,346**
Provisions, net	-2,580,844	-2,519,965	-3,296,244
Financial income/(expenses), net	721,272	408,898	75,677
EBITDA	**3,384,961**	**400,517**	**2,074,318**
Depreciation and amortization	-3,114,770	-3,112,531	-3,225,357
EBIT	**270,191**	**-2,712,014**	**-1,151,039**
Interest expense, net	319,702	458,265	385,264
EBT	**589,893**	**-2,253,749**	**-765,775**
Corporate income tax	-353,770	46,058	20,215
Net income / (loss)	**236,123**	**-2,207,691**	**-745,560**

Balance Sheet of ESM [1]

In MKD tsd	2003	2002	2001
Non-current assets			
Property, plant and equipment	32,484,690	33,201,907	33,793,094
Assets under construction	12,504,289	11,519,979	10,317,443
Long-term investments	294,192	325,132	461,896
	45,283,171	**45,047,018**	**44,572,433**
Current assets			
Inventories	2,776,485	3,148,921	2,880,996
Trade receivables	3,864,379	3,744,409	4,224,096
Other receivables	1,062,379	1,252,976	1,288,442
Cash	350,379	324,750	742,032
	8,053,622	**8,471,056**	**9,135,566**
Current liabilities			
Short - term debt	1,028,010	707,110	397,196
Trade payables	3,760,203	4,392,336	3,544,523
Other payables	783,531	1,182,193	1,298,521
	5,571,744	**6,281,639**	**5,240,240**
Non-current liabilities			
Long - term debt	5,464,132	5,580,260	5,597,726
Deferred income from grants	**773,209**	**685,719**	**48,229**
Deferred tax liability, net	312,275	5,867	105,099
	6,549,616	**6,271,846**	**5,751,054**
Shareholders' Equity			
Share capital	**41,904,582**	**41,904,582**	**41,904,582**
Reserves	-689,150	-939,993	812,123
	41,215,432	**40,964,589**	**42,716,705**

[1] Audited financial statements prepared in accordance to IFRS.

10. Privatization Tender Process

1) Tender Announcement

- The privatization tender announcement will be published in domestic and international newspapers

2) Registration and Purchase of Tender Documents

- After signing the confidentiality agreement, potential participants in the tender can purchase the tender documentation

3) Submission of Expression of Interest

- Based on the data contained in the Information Memorandum, the potential bidders will submit their expression of interest for participation in the tender and provide the required information to demonstrate their eligibility

4) Pre–Qualification

- The potential bidders will be pre–qualified based on three criteria:
  - Operational experience in the relevant industry sectors
  - Market experience in liberalized markets
  - Financial strength

5) Due Diligence and Negotiation

- The pre-qualified bidders will be provided access to the data room, management presentations and site visits and will be invited to comment on the draft sale purchase agreement

6) Submission of Business and Investment Plan

- The tender participants will submit their Business and Investment Plan

7) Submission of Purchase Price Offer

- The tender participants will submit their Purchase Price for the Strategic Stake

8) Selection of the Tender Winner

- The winner of the tender will be selected based on the business and investment plan and purchase price offer

11. Contact Details

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